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## Reforming Canada's Financial Services Sector

### A Framework for the Future

June 25, 1999

Canada

## The Financial Services Sector

Strong, efficient and profitable financial institutions are vital to Canada's economic success.

Canada's financial institutions, including domestic and foreign banks, trust companies, insurance companies, caisses populaires and credit unions that make up the financial services sector, are among the economy's most important creators of jobs and wealth.

The federal government has introduced a comprehensive, fair and balanced package of reforms that will assist this valuable sector in a rapidly changing global economy.

### The Need for Reform

In response to the dramatic changes in technology and information services affecting the sector, and as part of its commitment to review the legislation governing Canada's federally regulated institutions every five years, the government established the Task Force on the Future of the Canadian Financial Services Sector in 1996.

Over the last two years the government has listened carefully to the views of Canadians, through their submissions to both the Task Force and to two parliamentary committees that studied and debated its report, as well as through meetings with many other groups.

The result has been the creation of a financial services policy framework for the future.

### The Guiding Principles of the New Policy

- Financial institutions must have the flexibility to adapt to the changing marketplace and to compete and thrive, both at home and abroad, in order to retain their role as critical sources of economic activity and job creation.
- Vibrant competition is necessary to ensure a dynamic and innovative sector and that individual and business consumers have a range of choice at the best possible price.
- Consumers, regardless of their income or whether they live in an urban or rural area, and individual businesses, whether they be large or small, should receive the highest possible standard of quality and service.
- The regulatory burden should be lightened wherever possible, consistent with prudential and public interest objectives.

### A Framework for the Future

The new framework for the financial services sector is the right policy at the right time:

- **Canada's banks** will benefit from greater flexibility to adapt to the changing business environment, including potential for joint ventures and strategic alliances; a more flexible ownership structure; a new holding company option; a broader range of permitted investments; a transparent merger review process; a commitment to examine capital taxes with the provinces; and streamlined regulatory processes.

- **Canada's trust companies** will benefit from a broader range of permitted investments, the examination of capital taxes with the provinces and streamlined regulatory processes.
- **Canada's life insurance companies** will have access to the payments system, a new holding company structure and streamlined regulatory processes.
- **Securities dealers and money market mutual funds** will have access to the payments system.
- **Canada's credit unions** will be able to restructure themselves to enhance their national presence and better serve their members.
- **Consumers** will have guaranteed access to standard low-cost accounts; a process to adjust to branch closures; increased competition for their business from stronger credit unions and new, community-oriented banks; an agency to ensure that financial institutions adhere to consumer protection policies; and access to an independent ombudsman to ensure that they are treated fairly.
- **Small and medium-sized businesses** will benefit from increased choice among financial services providers (stronger credit unions, new banks, and foreign bank branches) and an independent ombudsman. There will also be a more comprehensive database on small and medium-sized enterprise lending and a new analytical group at Industry Canada to ensure a better understanding of their financing needs.

### Promoting Efficiency and Growth

#### Highlights

The government is acting to provide greater structural flexibility for financial institutions to compete in the global marketplace. A regime to permit large mutual life insurance companies to demutualize is already in place.

The government will introduce:

- A new definition of widely held ownership that allows strategic alliances and joint ventures with significant share exchanges.
- A new holding company regime to provide greater structural flexibility.
- A transparent bank merger review process with a formal mechanism for public input.
- An examination of capital taxation policy with the provinces.

The holding company option will allow our financial institutions to compete more effectively through less restrictive regulation.

For example, Canada's banks will be able to place credit card operations into separate subsidiaries so they can better compete with unregulated companies that specialize in a single line of business.

New ownership rules designed to facilitate strategic alliances and joint ventures among financial institutions will also be put in place.

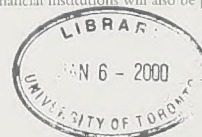
Under these changes, one shareholder – either an individual or an entity – will be able to own up to 20 per cent of a large chartered bank's shares. The limit for non-voting shares will be raised to 30 per cent. Previously, no one shareholder could have more than 10 per cent of a bank's shares.

The *Bank Act* will continue to prohibit any one shareholder or group from having control over any of the large banks.

The government is announcing a new, more transparent review process for mergers between large banks, which will allow for public input.

Merger proponents will be required to produce a Public Interest Impact Assessment, which the House of Commons Finance Committee will be asked to review.

The government recognizes that taxes on capital are an important element in determining the competitiveness of our banks. The federal government shares responsibility with the provinces in this important field, and will raise with them the effects of capital taxation on the financial services sector. As part of these discussions, the federal government is committing to a review of its own capital taxes.



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## Fostering Domestic Competition

### Highlights

The government is acting to increase the degree of competition in the domestic marketplace by:

- Encouraging new entrants with liberalized ownership rules and lower minimum capital requirements.
- Facilitating the ability of the credit unions to compete by allowing a restructuring of their system.
- Expanding access to the payments system to provide additional competition in deposit-like services.
- Allowing foreign banks to offer services to businesses and individual consumers via branches, in addition to subsidiaries.

Competition is the key to quality, price and choice of financial services for Canadians.

One way to increase competition in the sector is to encourage the creation of smaller financial institutions where people can bank.

To do this, the government is introducing legislation that will create a new three-tier ownership structure for banks based on equity:

- **Large banks**, those with equity in excess of \$5 billion, will be widely held under the new definition.

- **Medium banks**, those with equity between \$1 billion and \$5 billion, will be allowed to be closely held. Closely held medium-sized banks will be required to have a public float of 35 per cent of voting shares.

- **Small banks**, those with equity of less than \$1 billion, will have no ownership restrictions other than "fit and proper" tests.

This will allow the creation of community-based banks with services tailored to the needs of a specific community, but which will still be able to compete with the major banks in local or regional markets.

In addition to allowing single ownership of small banks, this policy change will allow companies, for instance, those with a network of stores or outlets, to own banks.

The government also intends to introduce legislation that would allow for stronger group co-ordination within the credit union movement. This will allow credit unions to operate on a truly national basis, possibly through a National Service Entity or a national co-op bank, and compete better with larger institutions here and abroad.

Taken together, these changes will facilitate entry for new players, both domestic and foreign, and enhance competition.

## Empowering and Protecting Consumers of Financial Services

### Highlights

The government is acting to provide better protection for consumers of financial services with:

- Measures to improve access to financial services regardless of income or place of residence, including a standard low-cost account and a process to govern branch closures.
- A Financial Consumer Agency to strengthen oversight of consumer protection measures and expand consumer education activities.
- An independent Canadian Financial Services Ombudsman.
- Measures to prevent coercive tied selling and improve the information consumers receive when purchasing services or making investments.
- Public Accountability Statements for financial institutions to report on their contributions to the Canadian economy and society.
- More and better statistics on and analysis of small and medium-sized business financing to provide a better understanding of their needs.

To be effective, any consumer protection regime must have three equally important components: an assurance that all Canadians get fair access to banking services; credible and accessible oversight and redress mechanisms; and strong consumer safeguards, including an accountability framework.

The government is providing all three.

It will introduce legislation requiring all banks to offer a standard low-cost account and stipulating that employment will not be a condition of opening a bank account.

The government will require federal deposit-taking institutions to provide at least four months' notice of branch closures and post notice of the closing date in the affected branch. In rural areas without another financial institution within a 10-kilometre radius of the closing branch, at least six months' notice will be required.

A new Financial Consumer Agency will be responsible for monitoring federal consumer protection legislation, promoting industry best practices and providing consumer education and information in the area of financial services.

This will be complemented by the establishment of an independent Canadian Financial Services Ombudsman, which will give Canadians a truly objective third party to resolve consumer-related disputes.

In addition, federal financial institutions with equity in excess of \$1 billion will be required to publish annual Public Accountability Statements.

The statements will include information relevant to the public, including the number of employees, small business financing initiatives, charitable contributions, efforts to improve access to banking services and the location of branch openings and closings.

## Improving the Regulatory Environment

### Highlights

The government is acting to make sure that the regulatory environment responds to the evolution of the sector by:

- Improving the governance of the payments system.
- Reducing the reporting burden relating to Canada Deposit Insurance Corporation standards.
- Providing the Superintendent of Financial Institutions with new powers to deal with the potential risks arising from increased competition.
- Streamlining the Office of the Superintendent of Financial Institutions' regulatory approvals process.

Canada has developed an international reputation for effective prudential regulation that protects all consumers and minimizes the risk to the financial system.

But in this era of rapid change and global competition, the government must continually find ways to streamline the regulatory framework to increase its effectiveness.

## How can I get more information on the 1999 financial services sector reform?

Information is available on the Internet at: <http://www.fin.gc.ca/>

You can also obtain copies of this pamphlet from:

Distribution Centre  
Department of Finance  
300 Laurier Ave. West  
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